The Senate Tax Patent Bill, Even Worse that the House Provision
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Senators had the benefit of examining the House-passed bill, including a provision dealing with "tax patents." However, instead of correcting errors in that provision when drafting their own bill, they compounded those errors in introducing S. 2369.

As noted in a prior article, the current definition of "tax planning method" in the House-passed patent bill would result in undercutting all patents, even those that have nothing to do with tax planning. This is because the definition of "tax planning method" includes "a plan, strategy, technique, or scheme that … has, when implemented, the effect of reducing, minimizing, or deferring, a taxpayer's tax liability." If this provision is read literally (as many courts do read federal law) this would encompass virtually all commercially successful patents as each of them has such an effect.

Any commercially successful product or technique that provides a competitive advantage would results in lower sales, profits and taxes for competitors. For example, any more efficient means of selling or producing goods or services would lower sales tax receipts and would presumably not be patentable if this legislation passed. Another example is a more efficient automobile result in lower taxes for fuel and could not be patented under the House bill provision.

Even if this provision were read more narrowly to require that a tax provision specifically address or be related to the technique, it would still be problematic. This is because after a patent application is required to be disclosed and while it is still pending a competitor of the inventor (e.g., a generic drug manufacturer) could hire a lobbyist to urge that Congress enact a minimal tax credit (e.g., 1 cent for every 1,000,000 pills) for manufacturers using the techniques disclosed in the patent application. If the lobbyist were successful, under the provision as drafted, a patent could then not be obtained for the new drug since utilization of the technique would reduce a taxpayer's liability.

Also, it is important to address the use of tax legislation to game the system utilizing a tax provision passed well after a patent application has been filed. A bill banning tax patents should provide that tax legislation enacted after a patent application is required to be published can not affect such an application, or, at the least, that tax legislation that has not been favorably referred by at least one committee of jurisdiction (currently Ways and Means in the House and Finance in the Senate) by the time a patent application is published can not affect that patent. This would preclude attempts to game the system by defeating competitors' innovations through lobbying tax committees after the specifics of the invention have been publicly disclosed.

The Senate bill takes these errors one huge additional step further when it provided that tax laws passed by foreign governments could also defeat patents in the United States. Foreign governments which wished to broadly defeat patents could pass a law, for example, that provides a tax benefit for all innovative products systems or techniques with proof of the innovativeness supplied by issuance of a United States patent. They could also more narrowly target patents that are published but not yet granted by simply copying the patent language from the Patent and Trademark Office Website. This would be particularly problematic under the proposed changes to patent law that would require publication of patent applications. For example, if Apple filed for patent protection for the next version of the iphone, a foreign government such as China, Iran or North Korea could defeat it by providing for a minute tax benefit in connection with the sale, manufacture or production of the invention, based on the published patent application.

The value of the tax benefit could be much less than the value of the patent defeated and could have virtually no value by limiting the scope. For example, the law could apply only in one city or town, or for a limited period of time, e.g., one day, or the law could not be enforced and therefore have no practical effect. Thus, under the Senate bill, foreign governments could simply veto US patents by passing laws with little or no practical effect.

Given the potentially sever results of the approach in the Senate bill and the provision in the House-passed bill, the effect of any provision attempting to ban "tax patents" should be limited to tax planning methods which have as their primary purpose the reduction, minimization or deferral of taxes. This would prevent its application to inventions that could affect tax liability where such effect is a not the primary goal of the invention such as, for example, a new technique for manufacture qualifying for a tax credit for research and development. Revising the definition so that only "tax planning methods" that meet a common sense meaning of that definition, i.e., those that have as their primary purpose the reduction, minimization or deferral of taxes, could avoid this result.

An even better way to address these issues may be to require disclosure of tax patents so that practitioners would have the ability to easily determine whether they would be infringing. In this connection, the following may solve much of the perceived problems concerning inadvertent infringement.

Taxpayers and practitioners are concerned that they may inadvertently infringe on tax patents and, in the case of the great majority of taxpayers, may not have the resources to investigate whether they have infringed. A common sense solution would be for the law to provide that taxpayers cannot be sued for infringement unless they are above very high income or estate limits (e.g., $1,000,000 in gross income, or estates in excess of $10,000,000, without the use of any patented tax strategy). While this may have almost no practical effect since it is likely it would not be cost effective to pursue any taxpayer other than one who was very wealthy, it would provide comfort to all but the wealthiest taxpayers. It is also practical in that at least one mechanism already exists to limit benefits to higher income taxpayers. In this connection, New York City limits rent control protections to persons who do not enjoy income that exceeds certain thresholds.

In the case of practitioners, the law might provide that a tax patent can only be enforced for a specified period after such patent appears in an easily searchable database. The inventor (or owner of the patent) would have the responsibility to describe the patent and place it in the appropriate categories and would have to prove that the patent was easily accessible and understood as a precondition to enforcing a patent.

Note that this suggested approach is substantially more generous than the burdens that would be imposed on inventors by proponents of the Senate bill. That bill would force inventors to search tax legislation worldwide, in foreign languages, without any requirement of an easily searchable or unified database. In view of this, proponents of the legislation should, if they are consistent, embrace this framework since it is so much more workable for them than their proposal would be for inventors.